

appropriate focus in this proceeding. Also, data are available for interstate return on investment, the specific earnings measure that has been considered by the Commission. SWBT can only speculate that MCI chose to use ROE for the RBHCs because it distorts the record.

Even ignoring MCI's use of RBHC data alone, however, MCI incorrectly manipulated the RBHC ROE calculations. MCI made selective adjustments to the numerator of the ROE calculations without making the corresponding adjustments to the denominator. MCI attempted to calculate ROE adjusted for extraordinary items for the RBHCs by specifically increasing the RBHC returns by the adjustments for extraordinary items, without making the corresponding adjustments for extraordinary items to the RBHC equity data in the denominator. Corrected data for the RBOCs, AT&T and MCI are presented below.²⁰

	<u>Return on Equity</u>		
	<u>RBOCs</u>	<u>AT&T</u>	<u>MCI</u>
1993	9.28%	19.61%	15.86%

Further disproving MCI's false allegations, SWBT, USTA and others have already demonstrated that the returns of the price cap LECs have been below the returns of the median of the S&P 400 and below the earnings of MCI and AT&T.²¹

²⁰ The source for this data is Compustat from Standard & Poors.

²¹ See evidence referenced in footnote 16 above.

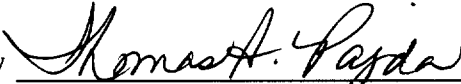
VI. THE COMMISSION SHOULD MOVE NOW TO MODERNIZE REGULATION OF THE PRICE CAP LECs.

The Commission should, without delay: (1) adopt a price cap plan as described in phase 1 of the USTA Proposal; and (2) initiate a specific, targeted proceeding to reinvent regulation of LECs to reflect market realities, as described in phase 2 of the USTA Proposal.

In spite of the best efforts of some parties to paint a picture of a failed LEC price cap plan, the truth is that the plan has generated the results it intended, and it is time for the Commission to proceed with a new plan that is simpler than the current one and more consistent with the changing environment. To do otherwise would not only dismantle the benefits which have been fairly shared by LECs and access customers, it would send a disturbing signal to the investment community, dampen the incentives for equity investors to put their capital in the LEC industry, and create disincentives for the LECs' parent companies to invest available resources in the regulated telephone networks.

Respectfully submitted,

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January 31, 1995

Rebuttal of MCI's Analysis of EBITDA

In its recent ex parte contacts with the Commission, MCI has attempted to use an operating cash flow analysis to persuade the Commission that price cap LEC earnings are unreasonably high. MCI's use of EBITDA data is irrelevant to price cap regulation. All MCI accomplished with their EBITDA analysis was to demonstrate the obvious fact that the LEC industry is capital intensive.¹

MCI presented data on EBITDA, Earnings Before Interest, Taxes, Depreciation and Amortization. The measure focussed on by MCI does not determine profitability. It measures earnings before subtracting out a number of very significant reductions to earnings, most notably before subtracting out depreciation and amortization expenses. As a result, EBITDA measures are greater if depreciation expenses represent a larger share of total expenses, as is clearly the case for the LECs.

MCI relies solely on comparison of EBITDA ratios between the LECs and other industries. Totally discrediting MCI's approach, however, is the commonly held fact that comparisons of EBITDA ratios between industries are absolutely meaningless for the purpose which MCI intends. EBITDA ratios differ significantly between industries primarily because different industries use vastly different production processes, serve significantly different product and service markets and therefore have substantially different relative levels of depreciation and amortization expenses.² Financial analysts clearly recognize that the level of EBITDA ratios cannot be meaningfully compared across industries and should only be used to compare the relative levels of cash flow, not profits or earnings, among firms within an a single industry where production processes are not expected to differ significantly.³

¹ For additional rebuttal of MCI on this issue, see: USTA written ex parte, dated January 20, 1995, from Mary McDermott, VP & General Counsel, USTA, to William F. Caton, Acting Secretary, FCC; and NYNEX ex partes, for example December 8, 1994 with Kathleen Wallman, Chief of the CCB and members of the CCB staff.; and BellSouth ex partes, for example December 8, 1994 with Kathleen Wallman, Chief of the CCB and members of the CCB staff.

² Different industries also differ in their interest relative amounts of interest and tax expense, which also influence the EBITDA ratios incorrectly used by MCI.

³ See, e.g., USTA written ex parte communication, dated January 20, 1995, from Mary McDermott, VP & General Counsel, USTA, to William F. Caton, Acting Secretary, FCC.

The RBOCs generate 60 cents in sales for every dollar of invested capital.⁴ AT&T generates \$3.45 for each dollar of invested capital, while MCI generates \$1.54 for each dollar of invested capital. Given that it takes more invested capital for LECs to generate sales of their services -- because of the very nature of the markets that they serve, compared to IXC's -- EBITDA ratios for LECs will tend to be higher for the LECs than for IXC's. This is a fact, pure and simple; it is not a "symptom" of an "illness" that revisions to the price cap plan will cure.


MCI's EBITDA analysis can be used only to conclude that the LECs employ a significant amount of capital in providing service; it cannot be used to conclude anything about the appropriate path of the current price cap performance review. The fact that LECs have higher depreciation expenses as a share of total expense cannot form the basis for the revisions to the price cap plan for LECs recommended by MCI.⁵

⁴ Ratios presented here are Sales as a Percent of Net Property, Plant and Equipment. The source for the data used in this paragraph is Compustat, from Standard & Poors.

⁵ This fact may serve to point out why reform of the Commission's depreciation prescription rules remains important to the LECs. Elimination of earnings sharing removes the last remaining roadblock to the Commission's ability to provide significant reform of the depreciation prescription rules for LECs. See SWBT Comments in CC Docket No. 92-296, filed March 10, 1993 at pp. 9-16.

CERTIFICATE OF SERVICE

I, Katie M. Turner, hereby certify that the foregoing, "Comments of Southwestern Bell Telephone Company" in Docket #94-1 has been filed this 31st day of January, 1995 to the Parties of Record.

A handwritten signature in cursive script, reading "Katie M. Turner", is written over a horizontal line.

Katie M. Turner

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